

**STATE OF CALIFORNIA**  
**DEPARTMENT OF FINANCIAL INSTITUTIONS**

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**ORGANIZING A STATE**  
**CREDIT UNION**

**INFORMATION**  
**BOOKLET**

## **SECTION I**

### **FOREWORD**

This information booklet is prepared for persons interested in organizing a state-chartered credit union. The material included is intended to provide basic information relative to credit unions and their formation.

### **WHAT IS A STATE CREDIT UNION?**

A State credit union is defined as a "cooperative, organized for the purposes of promoting thrift and savings among its members, creating a source of credit for them at rates of interest set by the board of directors, and providing an opportunity for them to use and control their own money on a democratic basis in order to improve their economic and social condition. As a cooperative, a credit union conducts its business for the mutual benefit and general welfare of its members with the earnings, savings, benefits, or services of the credit union being distributed to its members as patrons." (Section 14002, California Financial Code)

### **LAWS AND RULES FOR CREDIT UNIONS**

The Credit Union law is contained in the California Financial Code and begins with Section 14000. The Credit Union Regulations are contained in Title 10 of the California Code of Regulations, beginning with Section 30.101. Since all State-chartered credit unions are organized as nonprofit corporations, the requirements of the Nonprofit Mutual Benefit Corporation Law will also apply, unless restricted by the Financial Code. These provisions can be found in the California Corporations Code beginning with Section 7110.

The above laws and codes may be found in the reference sections of most libraries, at the Department of Financial Institutions website at [dfi.ca.gov](http://dfi.ca.gov), or may be purchased from the California Credit Union League (1-800-472-1702).

### **WHO MAY FORM A CREDIT UNION?**

Any group of persons having a "common bond" of occupation, association, or groups within a well-defined neighborhood, community or rural district, which number at least 500 persons, may be eligible for formation of a credit union. While a group consisting of at least 500 persons is the statutory minimum required to form a credit union, economic considerations generally mandate that a much larger group apply to obtain approval to form a credit union.

If the proposed group is too small to form a credit union, it can generally be approved to join an existing credit union's field of membership with much less effort and expense. Other credit unions will often accept small groups in their operating areas. Please feel free to discuss this possibility with our staff as this is frequently a less involved means of obtaining credit union service.

#### **FIELD OF MEMBERSHIP - COMMON BOND**

Credit Union membership must be limited to groups having a common bond. Common bond is a characteristic prerequisite to the fulfillment of a group objective, and when present among persons of related interests and purposes, these persons could be expected to effectively operate a credit union. Situations of common bond may occur most typically as follows:

**Occupation** - by the same employer and in that employer's related activities, or employment in which employees are so situated that as a consequence of their employment and relationship they could be expected to effectively operate a credit union.

**Example:**

"Employees of XYZ Corporation and of its subsidiary, ABC Company...", or "Employees of the Police Department of the City of San Francisco, California..."

**Association** - Membership in an association, organization, church or union whose members participate in activities developing common loyalties, mutual benefits, and mutual interests.

**Example:**

"Regular members of Local 23, United Carpenters and Joiners of America who reside in Santa Clara County, California, members of Local 23..."

**Residence** - Persons living within a well-defined geographic area who have a commonality of community interests, activities and objectives.

**Example:**

"Residents of Kern River Valley, California, within a twenty-five mile radius of the Wofford Heights Post Office..."

**HOW ARE FUNDS PROTECTED?**

1. Every credit union is required by law to have share deposit insurance or other insurance not unsatisfactory to the Commissioner. The shares of a majority of California credit unions are insured by the National Credit Union Share Insurance Fund, which is administered by the National Credit Union Administration, a federal agency.

2. Fidelity bonds are required for officers and employees having access to funds and securities.

3. Reserves and allowances are required to provide for losses on loans and investments.

4. Periodic examinations are conducted by the staff of the Department of Financial Institutions.

5. The supervisory committee, a necessary and integral part of every credit union, shall make or cause to be made annual audit and verification of members' accounts.

**ECONOMIC FEASIBILITY**

As in any business, the first three years of operations of a credit union are the most difficult and are often critical to its success.

The accumulation of capital and the making of prudent loans and investments is normally a gradual process with little income generation in the early stages. Therefore, a credit union that commits itself to large expenses at the outset may incur a severe financial burden that would be difficult to overcome in later periods. Frugality may not seem appealing, but it could mean the

**difference between success and failure for a new credit union.**

**The law allows a credit union to pay dividends to its shareholders only from undivided profits after expenses and statutory transfers to regular reserves have been paid or provided. Because adequate dividends are needed to attract new capital for growth, a plan of business must be prepared and will be carefully reviewed for the purpose of determining a potential credit union's ability to generate such profits.**

**Because a credit union starts with no reserves, losses on a few delinquent loans can quickly impair its capital. Therefore, careful screening of loan applicants and good loan collection procedures are important.**

**Some of the information that the staff of the Department of Financial Institutions will review in assessing the economic feasibility of a credit union are as follows:**

- 1. Plan of Business - Is it thorough and realistic?**
- 2. Business skills of management and employees.**
- 3. Commitment of volunteer officials and their own business abilities and skills.**
- 4. Potential membership**
  - a. Level of loyalty and interest.**
  - b. Anticipated needs for office space and equipment.**
  - c. Number of qualified borrowers to support projected loan demand.**
- 5. Sponsorship**
  - a. Payroll deductions**
  - b. Use of space and equipment**
  - c. Utilities, telephone**
  - d. Employee time**
  - e. Cash subsidies**
  - f. Share deposits ("seed capital")**

**Regarding item #5 above, a letter from the sponsor committing to any forms of support are necessary in evaluating the prospects of a proposed credit union.**

**Subsidies can be a considerable aid in overcoming the initial economic**

challenges of a credit union, but the plan of business must be geared to the credit union operating without outside help within a reasonable period of time.

### **WHO MANAGES A CREDIT UNION?**

Each member has a single vote, regardless of the amount of money on deposit. Members elect a board of directors and a supervisory committee. The credit union may adopt bylaws to provide for the election of a credit committee by the board of directors, or the board of directors may approve a credit manager, who is a paid, professional employee, in lieu of a credit committee.

Since a credit union is a cooperative corporation, its officers are volunteers and are not compensated. Only employees may be paid for their work performed.

Initially, a credit union may be able to afford only one employee, who will serve as manager. It is very important that the manager and employees be able to maintain proper accounting records, prepare financial reports, and manage credit union business, such as loan procedures and bad debt collections.

The duties and responsibilities of credit union volunteer officials are summarized as follows:

### **BOARD OF DIRECTORS**

- a. Acts on applications for membership.
- b. Obtains bond coverage for officers and employees.
- c. Sets the rate of interest to be charged on loans.
- d. Sets the maximum number of shares that may be held by a member and the maximum amount that may be loaned to a member.
- e. Declares dividends and establishes the dividend rate.
- f. Authorizes payment of interest refunds to borrowers.
- g. Amends the bylaws.
- h. Authorizes investments and withdrawals.

- i. Approves expenses.

### **CREDIT COMMITTEE OR CREDIT MANAGER**

The credit committee or credit manager has the responsibility to review loan applications of members in order to ascertain their ability to repay the loans and to assess the adequacy of security offered. The committee or credit manager should also endeavor to assist applicants in solving any financial problems. The committee meets weekly or more frequently, if necessary, to review members' applications for loans. Certain responsibilities of the credit committee or the credit manager may be delegated to one or more loan officers.

### **SUPERVISORY COMMITTEE**

The supervisory committee is charged with the responsibility to perform or obtain an annual audit of the books and records and an examination of the business and affairs of the credit union. The supervisory committee must report its findings to the board of directors and to the members. In addition, it must make an annual verification of all member accounts and report the results to the Department of Financial Institutions.

The supervisory committee has the power to suspend directors, members of the committees or officers; call shareholders' meetings; inspect the books and records and temporarily fill any vacancy in their own committee. The supervisory committee usually meets every three months to examine the affairs of the credit union.

### **WHAT WILL IT COST TO FORM A CREDIT UNION?**

The initial cost is made up of the following items:

1. Filing Fees - Secretary of State
2. Tax Prepayment - Franchise Tax Board
3. Recording Fee - County Recorder
4. License Fee - Department of Financial Institutions
5. Bond Premium

## **6. Supplies**

In order to pay for these initial costs, 15 to 20 prospective members (the organizers) usually advance funds to the credit union. After the credit union has received its Certificate to Act as a Credit Union, the amount advanced by each person is credited to his share account.

## **WHAT IS THE DEPARTMENT OF FINANCIAL INSTITUTIONS?**

The Department of Financial Institutions is the State agency charged with the responsibility for the administration and regulation of the California Credit Union Law.

Offices of the Department of Financial Institutions are located at:

300 South Spring Street, Suite 15513  
Los Angeles, California 90013-1204  
(213) 897-2226

111 Pine Street, Suite 1100  
San Francisco, California 94111-5613  
(415) 263-8500

1810 13<sup>th</sup> Street  
Sacramento, California 95811  
(916) 322-5966

7575 Metropolitan Drive, Suite 108  
San Diego, California 92108  
(619) 682-7227

## **SECTION II**

### **ORGANIZERS**

The Department of Financial Institutions welcomes opportunities to encourage sound development of the credit union movement through the ready organization of qualified new credit unions. Credit union organizers may welcome the assistance of a representative of the Department of Financial



Institutions, another credit union, or any person whose training and experience qualify him or her to assist in such organization. The organizer should stimulate the interest and enthusiasm present in the group, unless it becomes clear that the group will not qualify for a charter.

Credit union organizers are encouraged to lead charter-organization meetings and instruct new officials. They can be of real service by keeping in close contact with a new credit union and by assisting the new officials in solving initial operating difficulties and in aiding in the development of an aggressive educational program.

### **INVESTIGATION PRIOR TO INCORPORATION**

The preliminary investigation is important as it enables the organizer to learn about a prospective group's particular needs. It provides an opportunity to explain the advantages and objectives of the credit union plan. The more completely the organizer understands the group, the more able the organizer will be to guide its members and officials and lay the foundation for a sound credit union.

### **REQUESTS FROM PROSPECTIVE GROUPS**

A credit union organizer should give prompt attention to a request from a prospective group. The organizer should arrange with a representative of the group to hold a mutually convenient meeting to discuss the organization and operation of a credit union. At this meeting the organizer should obtain all necessary information about the group so that there can be a definite decision as to whether the group meets the requirements necessary to form a credit union. This decision should be obtained before the group commences with incorporation or any other phase of organization. If the group is clearly ineligible, all activity towards organization should be discontinued and the group fully informed as to why they do not qualify.

### **CHARTER-ORGANIZATION MEETING**

This meeting must include all those persons who have agreed to serve as members of the Board of Directors, Credit Committee and Supervisory Committee. All other potential members of the credit union should be encouraged to attend.

#### **(a) Consultant's Presentation**

**The consultant should advise the group of general procedures and requirements in forming a credit union.**

**The following subjects should also be covered:**

**(1) Management and membership control of a credit union stressing the responsibility of the group for operating a successful credit union and the importance of the cooperative thrift and credit services a credit union can provide;**

**(2) Functions of the Department of Financial Institutions, including licensing, supervision, examination and the fees charged;**

**(3) Qualifications of effective directors and committeemen, including their duties and responsibilities;**

**(4) Opportunities and responsibilities of the members and need for maximum participation in services provided by the credit union; and**

**(5) Functions of State and National credit union trade organizations.**

**Sufficient time should be allowed for a question and answer period.**

**Following the presentation and a discussion period, the member-subscribers will select the persons they desire to serve on their Board of Directors, Credit Committee and Supervisory Committee. Then a credit union name will be selected. Make a first and second choice.**

**At this point, the Charter-Organization meeting should be adjourned and a new meeting of the selected officials (incorporators), should be immediately convened.**

#### **(b) Incorporators Meeting**

**At this meeting, the incorporators decide who will fill the positions of corporate officers and committee members.**

**Those selected will proceed with the following:**

**(1) Complete and sign the Application for Authority to Form a Credit Union.**

**(2) Each official must complete and sign a Statement of Identity and Questionnaire (Form S.I.Q. 512) and Affidavit of Understanding the Credit**

## **Union Laws and Regulations.**

**(3) Complete the Agreement by Directors and Committeemen to Serve which should be attached to the application as Exhibit "D".**

**(4) Complete and sign four (4) sets of Articles of Incorporation.**

**(5) Complete two (2) sets of Bylaws.**

**(6) Select the insurance carrier for the Surety and Fidelity Bond.**

**(7) Select the insurance carrier for the Worker's Compensation Insurance (if needed.)**

**(8) Select the vendor(s) from whom supplies are to be purchased.**

**(9) The treasurer should collect at least \$25 from each incorporator for the purpose of financing the cost of organization and supplies. After the credit union obtains its "Certificate of Authorization to Act as a Credit Union", these amounts will be recorded into the records as a share deposit of each individual.**

**The consultant should now explain the order in which organization will proceed, which is as follows:**

**(1) The Application for Approval to Form a Credit Union is to be submitted to the Department of Financial Institutions.**

**(2) After all application requirements have been met, the Department of Financial Institutions will issue a letter of initial approval to organize a credit union.**

**(3) Upon completion of all the stipulations contained in the letter of approval to organize a credit union, the Department will issue the Certificate of Authorization to Act as a Credit Union. Receipt of this Certificate permits the credit union to commence business.**

## **ARTICLES OF INCORPORATION**

**The Articles of Incorporation should be filed with the Secretary of State in Sacramento. The Secretary of State should be requested to file one set of Articles, certify two sets and stamp mark one set. The two certified copies and**

marked set are to be returned to the President. (Enclose a self-addressed envelope.) One certified copy of the Articles of Incorporation should be recorded with the County Recorder of the county in which your main office will be located.

### **ORDERING SUPPLIES**

New credit unions should be guided by reason in ordering supplies to meet anticipated needs. A supply of accounting and report forms should be on hand when operations commence.

Supplies can be obtained through the California Credit Union League or other suppliers.

### **BONDING COMPANIES**

There are a number of insurance companies other than those affiliated with the California Credit Union League who write the type of insurance coverage needed by a credit union. It is suggested that you contact your insurance broker or the League.

### **FIRST STEPS IN ORGANIZING**

If you decide to apply for a State credit union charter, complete the enclosed application and attach a check for \$5.00 made payable to the Department of Financial Institutions, and mail it to either (depending on the region where the proposed credit union will be headquartered):

Joni Kimbrell, Assistant Deputy Commissioner  
Department of Financial Institutions  
300 S. Spring Street, Suite 15513  
Los Angeles, California 90013-1204

OR

Lana Tom, Assistant Deputy Commissioner  
Department of Financial Institutions  
111 Pine Street, Suite 1100  
San Francisco, California 94111-5613